

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Joint Petition of Boston Edison Company,)
Cambridge Electric Light Company,)
Canal Electric Company and) D.T.E. 06-40
Commonwealth Electric Company d/b/a)
NSTAR Electric for Approval of Merger)

INITIAL BRIEF OF RETAIL ENERGY SUPPLY ASSOCIATION

INTRODUCTION

The Retail Energy Supply Association (“RESA”) is a nonprofit organization and trade association that represents the interests of its members in regulatory proceedings in the New England, New York, Mid-Atlantic and Great Lakes regions. RESA’s members include providers of competitive supply products to electricity consumers in the five New England states – including Massachusetts – that have restructured their electric markets.¹

RESA is pleased to submit its Initial Brief to address key issues raised in the May 26, 2006 Joint Petition of Boston Edison Company (“Boston Edison”), Cambridge Electric Light Company (“Cambridge”), Canal Electric Company (“Canal”) and Commonwealth Electric Company (“Commonwealth”) d/b/a NSTAR Electric for Approval of Merger (“Joint Petition” or “Petition”), the supporting May 26, 2006 Pre-filed Testimony of Christine L. Vaughan (“Vaughan Testimony” or “Vaughan PFT”) for NSTAR Electric and its subsidiaries (collectively “NSTAR” unless individual company names are used), and live testimony of Ms. Vaughan and

¹ RESA member companies include Consolidated Edison Solutions, Inc., Direct Energy Services, LLC, Hess Corporation, Reliant Energy Solutions, Sempra Energy Solutions, Strategic Energy, LLC, SUEZ Energy Resources NA, Inc. and U.S. Energy Savings Corp. The opinions expressed in this filing may not represent the views of all members of RESA.

other NSTAR witnesses at evidentiary hearings conducted by the Department of Telecommunications and Energy (“Department”).

The Department is required to closely examine the NSTAR merger proposal under the well-established “no net harm” standard for reviewing petitions pursuant to G.L. c. 164, § 96.² NSTAR has chosen to defer several key merger-related issues until a future date, including the important issue of which tariff provisions of the individual NSTAR companies will apply to NSTAR as a whole.³ The Department must look carefully at those issues if and when they are presented to it for decision.

Nevertheless, NSTAR has elected in this proceeding to propose certain changes to its Basic Service tariffs.⁴ NSTAR specifically requests that Basic Service rates be “consolidated” for all small commercial and residential customers located throughout its service territories.⁵ As discussed in more detail below, RESA requests that the merger plan be modified to reject the proposal to introduce substantial additional “consolidation” or “blending” of Basic Service prices in the NEMA and SEMA load zones for small commercial and residential customers located in NSTAR territories.⁶ While NSTAR currently blends rates from different locational marginal pricing (“LMP”) zones within the Boston Edison service territory for the small commercial and

² See e.g., Eastern-Colonial Acquisition DTE 98-128 (1999); Eastern-Essex Acquisition, DTE 98-27 (1998); NIPSCO-Bay State Acquisition, DTE 98-31 (1998); and Boston Edison/Commonwealth Energy System Merger, DTE 99-19 (1999).

³ See Vaughan PFT at 8 (discussing the need “eventually” for “a united rate structure and common tariffs”); Tr. 7 (testifying that the rate unification issue “will be determined in a future proceeding”).

⁴ See Vaughan PFT at 12-16 (proposing changes to default service rates and pension benefit adjustment factor).

⁵ Id. at 12-14; Tr. 79.

⁶ See Vaughan PFT at 12-14.

residential classes,⁷ the Department recognized more than three years ago that consolidated Basic Service rates across load zones “could skew the market, thereby impeding the development of competition”⁸ and stated that the Department intended to “revisit this issue after experience is gained” with zonal differences in congestion costs and the development of competition in these customer classes.⁹

Notwithstanding these serious policy concerns, NSTAR, without providing anything even closely resembling substantial record evidence, proposes to implement fully consolidated rates for all of its customers in NEMA and SEMA zones. NSTAR submits its consolidated zonal rates proposal without citing the applicable Department precedent and without recognizing, accepting or attempting to quantify on the record any of the adverse consequences for competition and customers that the Department had previously identified and found worthy of continued investigation more than three years ago. Indeed, NSTAR’s claim that its blended rate proposal is appropriate because differences between NEMA and SEMA load zone rates are “relatively small” and expected to be “minimal and declining in the future”¹⁰ is unsupported and contradicted by voluminous record evidence and should be rejected.

Accordingly, as discussed in more detail below, the public interest would be harmed by, and the record in this proceeding does not support, substantially expanding the scope of rate blending in Eastern Massachusetts by combining the Boston Edison load with: (1) Commonwealth load (which is located exclusively in SEMA and has historically been procured

⁷ Investigation by the Department on its own Motion Into the Provision of Default Service, DTE 02-40-A (February 13, 2003), p.11 (hereinafter “LMP Order”).

⁸ Id. at 9.

⁹ Id. at 11.

¹⁰ Vaughan PFT at 14.

on a zone-specific basis); and (2) Cambridge load (which is located exclusively in NEMA and has historically been procured on a zone-specific basis). The Department should therefore seek to avoid the adverse competitive impacts, adverse customer impacts and efficiency and public interest harms resulting from distortions in market price signals that would ensue from the proposed substantial expansion of rate blending across the load zones.¹¹ Instead, the Department should order NSTAR in this proceeding to implement zonal pricing for small commercial and residential customers using zone-specific solicitations for that purpose.

PRIOR PROCEEDINGS

NSTAR filed the Joint Petition, Vaughan Testimony, and supporting exhibits on May 26, 2006, seeking Department approvals under G.L. c. 164, § 96 for a merger of NSTAR subsidiaries Cambridge, Commonwealth and Canal into Boston Edison.¹² Boston Edison will be the sole surviving corporate entity and thereafter will change its corporate name to the NSTAR Electric Company (“NSTAR Electric”).¹³

Following a June 29, 2006 procedural conference, the Hearing Officer granted party status to the Attorney General, Cape Light Compact, the Energy Consortium, the President and Fellows of Harvard College, Massachusetts Institute of Technology and RESA; and limited participant status to Direct Energy Services LLC (“Direct”) and Northeast Energy Associates.¹⁴ The Hearing Officer also established a procedural schedule and discovery deadlines.¹⁵

¹¹ Currently, less than 10% of Boston Edison load is blended; if the proposal is adopted, nearly 40% of NSTAR load would be blended, a huge increase. See Tr. 79-81 (Vaughan testimony).

¹² Joint Petition at 1-2.

¹³ Id. at 2; Vaughan PFT at 4.

¹⁴ See July 6, 2006 Hearing Officer Memorandum. Direct is a member of RESA and Direct hereby relies on the instant brief as its Initial Brief in this docket.

¹⁵ See id.

Numerous parties propounded discovery requests to which NSTAR responded. Hearings were held on August 14-17, and 23, with testimony provided by Ms. Vaughan, Henry Lamontaigne and several other NSTAR witnesses. NSTAR also provided responses to record requests inquired of it during the hearings. During the hearings, the Hearing Officer extended the deadlines for submitting Initial and Reply Briefs to September 6, 2006 and September 15, 2006, respectively.

ARGUMENT

A. The Department Must Carefully Consider the Impacts of the NSTAR Merger on Customers, Competitors and the Public Interest.

As conceded by NSTAR, the instant merger petition pursuant to G.L. c. 164, § 96 is subject to the well-established “no net harm” standard.¹⁶ In reviewing a merger subject to this standard, the Department will consider a large number of factors in order for petitioners to establish that there is an “avoidance of public harm” and that the “public interest would be at least as well served by approval of a proposal as by its denial.”¹⁷ These factors include “impact on rates,” “impact on competition,” and “societal costs and benefits of the merger.”¹⁸

B. The Department Should Carefully Review NSTAR’s Future Tariff Consolidation Efforts.

Pursuant to the Settlement Agreement approved in DTE 05-85, NSTAR will maintain separate distribution rates and transition charges for the three existing NSTAR service territories

¹⁶ Vaughan PFT at 5-6 (citing Eastern-Essex Acquisition, DTE 98-27 (1998), NIPSCO-Bay State Acquisition, DTE 98-31 (1998) and Boston Edison/Commonwealth Energy System Merger, DTE 99-19 (1999)); see also Joint Petition at 2.

¹⁷ Joint Petition at 2 (citing Boston Edison-Commonwealth Energy System Merger, DTE 99-19 at 10); Vaughan PFT at 5.

¹⁸ Vaughan PFT at 5-6.

until at least January 1, 2010.¹⁹ In doing so, NSTAR will retain separate tariffs for the service territories and will defer the decisions concerning which particular tariff provisions will be proposed for governing the unified NSTAR Electric Company until a later date.²⁰

While NSTAR's unified tariffs is not before the Department in this proceeding, the issue is of concern because its resolution could have a profound impact on competition -- both from the standpoint of customers and marketers such as the RESA member companies. It is therefore imperative that the Department closely review NSTAR's unified tariffs proposal when it is submitted at some future date. In particular, the dividing line between medium-to-large commercial customers entitled to Basic Service rates that closely track the market through three-month procurement cycles and the small commercial and residential customers that have procurements of not less than six months that may be extended under the NSTAR Settlement Agreement approved in DTE 05-85²¹ is likely to be of critical importance in determining which NSTAR customers will have access to the market price signals needed to evaluate and take advantage of competitive service offerings.

¹⁹ Id. at 9.

²⁰ Id. at 8 (discussing that "eventually" NSTAR will implement a "unified rate structure and common tariffs"); Tr. 77 (testimony of Ms. Vaughan acknowledging that most tariffs are not proposed to be changed as part of the Joint Petition).

²¹ See Petition of Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company and NSTAR Gas Company, pursuant to General Laws Chapter 164, § 94, and 220 C.M.R. §§ 5.00 et seq. for approval of a rate settlement effective July 1, 2006, DTE 05-85 (December 30, 2005), p 9 (noting that the Settlement Agreement calls for NSTAR to work with the Attorney General to implement a staggered procurement schedule for small commercial and residential customers, including consideration of longer-term contracts).

C. The Public Interest Will Be Harmed if NSTAR is Permitted to Consolidate Boston Edison, Commonwealth and Cambridge Basic Service Rates for Small Commercial and Residential Customers.

1. The Department Should Reject the Unsupported and Harmful Proposed Expansion of Rates in this Proceeding.

The Joint Petition and Vaughan PFT propose to consolidate Basic Service rates for Boston Edison, Commonwealth and Cambridge small commercial and residential customers across both the NEMA and SEMA load zones, without making any effort to justify the proposal under Department precedent or the “no net harm” standard for merger petitions. The proposal should be rejected, and the Department should adopt full zonal pricing for the small commercial and residential customer classes for the reasons discussed in Section C.2 below.

- a. The Department has recognized the potential adverse impacts of blended rates on customers and competitors in the Commonwealth.

In its LMP Order issued in February 2003, the Department addressed the effects of congestion costs and LMP on default service rates and specifically recognized the potential adverse impacts of blended rates on both customers and competitors in the Commonwealth:

With one service territory-wide rate, default service customers located in constrained zones, where high congestion exists, would pay a price lower than could be offered by the competitive market. Default service customers located in unconstrained zones, where relatively less congestion exists, would pay a price higher than would be competitively determined.... Over the long run, competitive suppliers may tend to sign up customers in the non-constrained zones, leaving customers from the constrained zones more likely to rely on default service for want of attractive competitive options.²²

²²

LMP Order at 9 n. 6.

Faced with these acknowledged adverse impacts, the Department held that zone-differentiated default service prices would avoid the form of market distortion that directly impacts customers and competitors.²³ The Department explained:

[I]n order to avoid introducing distortions into the competitive market, default service prices in each load zone should include the same level of congestion costs that suppliers serving load in that zone would incur. Zone-differentiated default service prices would avoid one form of distortion in the market, and competitive suppliers would stand on better footing to service customers in all zones than they would otherwise. Averaging LMPs to determine a single service territory-wide default service rate could skew the market, thereby impeding the development of competition.²⁴

Based on these recognized policy concerns, the Department ordered Boston Edison and Massachusetts Electric – at the time the two distribution companies whose service territories extended across more than one load zone in the Commonwealth – to establish zone-specific prices for medium-sized and large commercial and industrial customers.²⁵ In contrast, because there were “few competitive options” for small commercial and residential customers and based on “relative costs and benefits of establishing zone-differentiated default service prices” at that time, the Department permitted Boston Edison and Massachusetts Electric to establish service territory-wide rates, averaged across load zones.²⁶ The Department also stated its intention to: (1) revisit this issue after experience with zone-specific pricing was gained;²⁷ and (2) require the distribution companies to procure default service supply for the small commercial and residential customer classes on a zone-specific basis “[t]o assist the Department in evaluating the

²³ See id. at 8-9.

²⁴ Id.

²⁵ Id. at 11.

²⁶ Id. at 10-11.

²⁷ Id. at 11.

differences in procurement costs among the zones.”²⁸ This proceeding presents the perfect opportunity for the Department to revisit its decision to allow the blending of Basic Service rates in the Boston Edison service territory in light of NSTAR’s plan to conduct company-wide procurements by rate-class and zone after the merger.

- b. NSTAR has wholly ignored the adverse impact of consolidation on customers, competitors and the public interest.

Despite the Department’s clear guidance in the LMP Order regarding zone-specific pricing, NSTAR summarily proposes blended Basic Service rates across all load zones while not only ignoring the Department’s clear guidance in the LMP Order, but also failing to mention the LMP Order itself. Indeed, NSTAR’s Petition and the accompanying Vaughan Testimony essentially treats the Department’s prior rejection of blended rates as if it had never occurred. The potential adverse impacts on customers, competitors and the broader public interest are not mentioned or analyzed for purposes of the “no net harm” standard anywhere in the NSTAR filing. In fact, Ms. Vaughan spent extensive portions of the cross-examination by RESA appearing to deny that there were any adverse impacts to anyone from blending rates across different load zones.²⁹

The adverse impacts resulting from the NSTAR consolidation proposal are, however, clearly established by the record evidence. First, the blended rates have a direct impact on the prices consumers pay for electricity and their ability to see proper market signals that might lead them to seek out available competitive alternatives. As recognized in the text of the LMP Order quoted supra (from page 9, footnote 6), customers in the highly-constrained NEMA zone are

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Id.

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See, e.g., Tr. 93-105 (extensive questioning of Ms. Vaughan where she failed to acknowledge any harms to competitors from blended rates).

likely to pay Basic Service prices substantially lower than could be offered by the competitive market, and customers in the lesser-constrained SEMA region will likely pay Basic Service prices substantially higher than could be offered by the competitive market, according to statistics proffered by NSTAR.³⁰

Second, as the Department expressly recognized in the LMP Order, these non-differentiated rates “could skew the market, thereby impeding the development of competition.”³¹ RESA strongly believes that having non-market-based pricing obstacles in place in one load zone and non-market-based pricing advantages in the other is an exceptionally poor way to ensure meaningful and beneficial long-term competition in the Commonwealth. As noted in the RESA Petition to Intervene in this docket, the ability of RESA members to compete effectively for customers does depend, and will continue to depend, on “reasonable and competitively neutral Basic Service pricing rules and procurement procedures that do not create a disincentive for customers to consider competitive supply alternatives.”³² The NSTAR proposal is contrary to pro-competitive policies and should not be adopted on this record.

Finally, the pricing distortions that would ensue from consolidated rates across differently priced load zones may cause adverse societal impacts as well.³³ In addition to the efficiency losses caused by customers making decisions based on over- or under-subsidized rates, rather than a true market-based rate, the distorted price signals may lead consumers to over-invest or under-invest in energy conservation and load management programs.

³⁰ See Tr. 109 (testimony by Ms. Vaughan confirming that the NEMA real-time LMP was as much as 18.2% higher than the SEMA real-time LMP in June 2006 based on data produced by NSTAR).

³¹ LMP Order at 9.

³² RESA Petition to Intervene at 2.

³³ Vaughan PFT at 5-6 (citing societal costs and benefits as a factor to be considered in determining whether the “no net harm” test has been met).

For all of these reasons, the Department should take this opportunity, as it said it would in the LMP Order, to revisit the blending of rates and direct NSTAR to discontinue this practice in favor of more competitively appropriate zonal pricing.

- c. NSTAR has overstated the limited benefits of consolidation.

In advancing its consolidated rate proposal, NSTAR chose to rely on claims that: (1) the “no net harm” standard was satisfied because the “aggregate level of rates will be no higher than if separate rates (and separate corporate entities) were maintained;”³⁴ (2) unspecified administrative cost savings would occur;³⁵ and (3) differential prices between the NEMA and SEMA zones are “expected to be minimal and declining in the future...”³⁶ Each of these grounds is factually unsupported and, in several instances, contradicted by the record.

First, the claim that the consolidation proposal would not affect “aggregate level of rates” and, therefore, would meet the “no net harm” standard ignores the Department’s instructions in the LMP Order that the particular rates that apply in each load zone do indeed matter very much to consumers and competitors. As the Department stated plainly in the LMP Order, “[a]veraging LMPs to determine a single service territory-wide default service rate could “skew the market, thereby impeding the development of competition.”³⁷ If maintaining aggregate rate levels were all that were important, as NSTAR contends, the Department would have accepted NSTAR’s earlier recommendations in the LMP proceeding to adopt blended rates for all customer classes.³⁸

³⁴ Vaughan PFT at 12.

³⁵ Id. (citing that consolidation will help “minimize the administrative burden of maintaining separate schedules, analyses and filings for what is essentially one operating company”).

³⁶ Id. at 13-14.

³⁷ LMP Order at 9.

³⁸ See id. at 7 (discussing NSTAR proposals).

Second, NSTAR made no effort to quantify the amount of administrative savings from its proposed consolidation. Indeed, administering NSTAR's consolidated rate proposal would likely be more burdensome for the company than would a full zonal pricing model. Ms. Vaughan confirmed that the surviving company, NSTAR Electric, will abide by the LMP Order and continue to procure Basic Service supply by load zone and customer class.³⁹ This means that NSTAR will derive a NEMA price and a SEMA price for the small commercial and residential customer classes through its procurements. There is no good reason why NSTAR should not price Basic Service for these customer classes by zone based on the zonal supply contracts that will be awarded. To be sure, there is no administrative efficiency to be gained by taking the added step of consolidating the NEMA and SEMA bid prices into blended Basic Service rates.

Third, the claim of "minimal and diminishing" price differences between NEMA and SEMA zones is contradicted by the record, which shows a trend of increasing zonal differences as new congestion charges are being added into both NEMA and SEMA default rates. As congestion charges have caused substantial changes in Basic Service prices in ways that even NSTAR admits cannot be predicted in advance,⁴⁰ the claim that Basic Service prices across zones will become virtually identical, alleviating concerns about market price distortion, becomes more and more untenable. Further, the extent to which NSTAR's new 345kV line will

³⁹ See Vaughan PFT at 12 ("Basic Service Contracts are awarded to the winning bidder(s) from the competitive market with the lowest price in each load zone and customer class. This will not change. The only difference is that the suppliers will contract with NSTAR Electric instead of the separate companies"); see also LMP Order at 11 (mandating separate zonal solicitations for small commercial and residential customers).

⁴⁰ See, e.g., Tr. at 114 (Vaughan acknowledgement that NSTAR cannot accurately predict new congestion costs imposed by ISO-NE).

have a dampening effect on these substantial pricing differentials⁴¹ is not quantified anywhere in the NSTAR filing and likely will not be known for several years after it comes on line, and cannot be counted on to justify rate consolidation at this time.

Finally, NSTAR's characterization of the price differences as "minimal" and "diminishing" ignores the fact that such differences do, in fact, exist, that those price differences will distort the market, that no one can wholly predict whether they will increase or decrease in the future and, perhaps most importantly, that the distorting impact of the price differences can be completely eliminated simply by setting Basic Service rates on the same basis as the supply is procured by NSTAR – that is, zonally.

For all of these reasons, the NSTAR consolidated rate proposal should be rejected under the governing "no net harm" standard.

2. The Department should direct NSTAR to Implement Full Zonal Pricing for its Small Commercial and Residential Customers.

The Department should order NSTAR to adopt full zone-specific Basic Service pricing as a condition for merger approval in this proceeding. Pursuant to this approach, NSTAR would establish separate NEMA and SEMA Basic Service rates for the small commercial and residential customer classes. Because these rates would flow directly from NSTAR's procurements, there is no need to use a blended rate for customers located in any of NSTAR's three existing territories.

At the August 14, 2006 hearing, however, The Hearing Officer stated that the issue of blended rates in the Boston Edison Service territory would not be revisited in this proceeding.⁴² This evidentiary ruling is illogical for two reasons. First, it contradicts the LMP Order in which

⁴¹ See Vaughan PFT at 14.

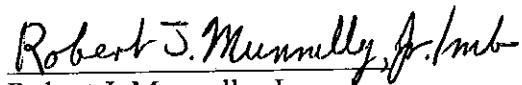
⁴² Tr. 89-90.

the Department stated that it would revisit the rate-blending issue in the future.⁴³ Second, it makes no sense for NSTAR to maintain a blended rate for the Boston Edison territory when the merged company, NSTAR Electric, will be procuring Basic Service power supply on a company-wide basis by rate-class and zone. RESA therefore urges the Department to overrule the Hearing Officer's ruling that the blending of rates in Boston Edison is beyond the scope of this proceeding.

CONCLUSION

RESA appreciates the opportunity to participate and provide written comments in this important proceeding that affects consumers and competitors in substantial portions of Eastern Massachusetts and Cape Cod. As discussed above, RESA respectfully requests that the Department reject the NSTAR petition to consolidate all rates for small commercial and residential customers across the NEMA and SEMA load zones, as contrary to principles articulated in the Department's February 2003 order in Docket No. 02-40-A and the governing "no net harm" standard. Instead, the Department should direct NSTAR to adopt full zone-specific pricing as a condition of the merger.

RETAIL ENERGY SUPPLY
ASSOCIATION



Robert J. Munnelly, Jr.
Diana M. Kleefeld
Murtha Cullina LLP
99 High Street – 20th Floor
Boston, MA 02110
Telephone: (617) 457-4062
Fax: (617) 482-3868
rmunnelly@murthalaw.com

Date: September 6, 2006

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LMP Order at 11.